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## DIRECTORATE OF INTELLIGENCE

24 September 1986

Prospects for Sino-Soviet Economic Relations 

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## Summary

Last week's trip to Beijing by Soviet First Deputy Premier and Chairman of the Planning Committee Nikolay Talyzin resulted in two agreements that will facilitate the implementation of five-year accords on trade and technical cooperation signed in July 1985. We expect that Sino-Soviet trade will meet the goal set in the 1985 trade agreement--\$14 billion over the 1986-90 period--with ease. Even so, Sino-Soviet trade will remain a small share--less than 5 percent--of each country's total trade. Technical cooperation will develop more slowly. Both sides have agreed that two dozen Chinese industrial facilities will be built or upgraded with Soviet assistance, although many of the details of this arrangement have yet to be worked out.

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Economic cooperation under both agreements will be constrained by the problems Beijing will have with the supply and transport of goods to pay Moscow for both trade and cooperation. Growth in bilateral trade will also be limited because it is almost entirely conducted on a barter basis, a cumbersome arrangement under which representatives from the

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two countries must annually negotiate prices and quantities of goods to be traded. And technical cooperation--which appears to benefit China most--will be limited by Beijing's wariness of Soviet assistance and dissatisfaction with Soviet industrial technology. In any case, a growing economic relationship between the two countries will not inhibit US sales to China except in a few areas, such as timber, fertilizers, coal, and some industrial chemicals. [REDACTED]

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### **The Talyzin Visit: Ironing Out the Details for Future Cooperation**

The delegation, led by Soviet First Deputy Premier and Chairman of the State Planning Committee Nikolay Talyzin, met with Chinese officials in Beijing to discuss trade and technical cooperation under agreements signed in July 1985 (see inset). Talyzin was accompanied by Konstantin Katushev, Chairman of the Soviet State Committee for Foreign Economic Relations, Minister of Timber Mikhail Busygin, and Deputy Foreign Minister Igor Rogachev. Rogachev will lead an October delegation to China for the ninth round of bilateral consultations, and may have been included in the Talyzin delegation to raise political as well as economic issues. The Soviets met with Premier Zhao Ziyang, Vice Premiers Yao Yilin and Li Peng, Vice Foreign Minister Qian Qichen, and head of the Chinese State Planning Commission Song Ping. [REDACTED]

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According to press reports, two agreements were signed during the visit.<sup>1</sup> A consular agreement provides for trips to China by Soviet experts, students, and professors, and permits Chinese diplomats to transit the Soviet Union by train en route to Europe. A cooperation agreement between the State Planning Commissions of the two countries provides a formal framework for the trade and commercial exchanges to take place through 1990. [REDACTED]

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<sup>1</sup> Although the Soviets have implied that the meetings covered political as well as economic issues, China's hardline response to General Secretary Gorbachev's 28 July speech on improving relations with Asian countries leads us to believe that no political agreements were reached. Planning for the Talyzin visit began long before the speech; the Talyzin trip reciprocated a trip to the USSR by Yao Yilin last year to sign the trade and economic cooperation agreements. [REDACTED]

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**The Five-Year Agreements: Setting the Stage for Closer Economic Ties**

In July 1985, China and the USSR signed separate agreements on trade and economic cooperation over the 1986-90 period. The trade agreement--under which two-way trade is to total \$14 billion over the five-year period--established a framework for negotiating yearly trade protocols: annual accounting would continue as the norm, with negotiators meeting at yearend to determine any imbalances in trade, which must then be settled by the end of the first quarter of the subsequent year. The cooperation agreement, the first in more than 20 years, permitted China to pay over a multiyear period for imports of capital goods and technical assistance acquired under that pact. The agreements specified that all payments for both trade and technical cooperation would be in barter.

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**Bilateral Trade: Expanding Rapidly, But Within Limits**

We fully expect Beijing and Moscow to have little difficulty reaching the \$14 billion cumulative target for 1986-90 trade. If two-way trade is \$2.5 billion in 1986--the minimum we expect--then it need average only \$2.9 billion per year for the rest of the decade, a level we believe is attainable. At most, though, Sino-Soviet trade will remain a small share--less than 5 percent--of each country's total trade.

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Growth much beyond that level will be constrained by the cumbersome barter arrangement. Representatives meet annually to negotiate a detailed list of trade goods, including price and quantity. These negotiations are often prolonged and arduous, and may prove to be the key obstacle to substantial expansion of trade. Each country tries to sell its top-quality goods on world markets for foreign exchange, leaving lower quality items for barter trade; consequently, both sides approach the negotiations with caution. In addition, China may have trouble supplying the enormous volume of goods--in quality and prices acceptable to Moscow--that will be needed to pay for both trade and technical assistance. Moreover, the strain on already burdened transportation links between the two countries will interfere with deliveries over the next few years. Rail transport is so tight that many products are shipped by sea, and port congestion ties up both ships and cargoes. Planned improvements in rail and shipping facilities will not provide significant relief for several years.

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### Trends in Sino-Soviet Trade

According to Chinese customs statistics, Sino-Soviet trade approached \$2 billion in 1985 (see table 1). We estimate that two-way trade will exceed \$2.5 billion in 1986. The Soviets obtain Chinese foodstuffs, consumer goods (textiles, footwear, household goods), and metal ores primarily to meet demand in the Soviet Far East, which has suffered from shortages and high costs for transporting goods from the European USSR. In return, China acquires mid-level manufacturing equipment, such materials as timber, steel and nonferrous metals, and transportation equipment, including aircraft, locomotives, and trucks. Sino-Soviet trade is conducted almost entirely on a barter basis.

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Informal trade across the border is a small but growing factor in Sino-Soviet relations. We estimate that it represents less than 1 percent of total China-USSR trade, but we believe it is likely to increase. This trade is conducted between Chinese provincial authorities and Soviet Far Eastern trade officials. It is not clear how much of it is counted under the national agreement. At a recent conference in Harbin, several Chinese provinces began making arrangements to engage in border trade with the USSR using Heilongjiang Province as an agent or facilitator. If these ties come to fruition, we expect border trade to increase rapidly. Beijing then may require such trade to pass through national channels to maintain some control over Sino-Soviet trade and to ensure that exchanged goods are properly counted against the bilateral trade agreement.

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Table 1

Million US\$

#### China's Trade with the Soviet Union, 1980-85

Year	Imports	Exports	Total	Balance
1985	937.2	994.2	1,931.4	57.0
1984	574.6	625.2	1,199.8	50.6
1983	339.7	307.9	647.6	-31.8
1982	165.2	142.6	307.8	-22.6
1981	115.9	131.7	247.6	15.8
1980	293.5	229.9	523.4	-63.6

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### Technical Cooperation: Inching Forward

Earlier this year, Beijing and Moscow fleshed out some of the details of industrial cooperation under the 1985 accord. The countries are exploring the possibility of Soviet assistance to China in renovating 17 factories and in building seven new enterprises. Both sides have agreed on cooperation in electric power, metallurgy, machinery, textiles, and coal-processing industries; the Soviets have also proposed assistance in nuclear energy, although Beijing's response has been lukewarm--especially since the Chernobyl accident. [REDACTED]

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The two countries probably discussed additional projects during the Talyzin visit, but, to date, have provided few details. One Western newspaper citing Soviet sources indicated that the program would require more than 100 Soviet experts to be sent to China over the next few years. The sources also hinted that the Soviets might eventually provide technical assistance for the modernization of up to 100 Chinese factories. According to Embassy reporting, negotiators agreed that Chinese technical experts would soon begin making two- to three-week visits to the Soviet Union to assess the appropriateness of Soviet technology. Talyzin reportedly also raised the possibility of finding ways for Soviet and Chinese enterprises to cooperate directly, including through joint ventures. [REDACTED]

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Constraining Sino-Soviet technical cooperation is China's dissatisfaction with the out-of-date technology the Soviets are offering, and Beijing's preference for upgrading factories with more sophisticated--if more expensive--US, Japanese, or West European assistance. [REDACTED]

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[REDACTED] extended technical cooperation will depend largely on Beijing's perception of the costs in goods as well as the attitude of Chinese officials toward having on-site participation by Soviets. Technical cooperation, like trade, will also be limited by China's need to produce and transport goods with which to pay for Soviet advice and equipment. If early projects proceed smoothly, we expect additional Soviet involvement. The technical cooperation program could be abruptly terminated, however, if Soviet interest in cultivating the appearance of closer ties diminishes, or if Soviet officials grow weary of Beijing's pointed efforts to showcase the economic achievements China has made since moving away from the Soviet economic model. [REDACTED]

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### Who Benefits From Closer Sino-Soviet Economic Ties?

Both countries benefit from the trade relationship, especially because it is conducted almost entirely on a barter basis. China's interest in barter has grown because the country's foreign exchange reserves have declined over the past two years; Beijing views trade with the Soviets as one way to acquire needed goods without spending foreign exchange. The Soviets, too, have foreign exchange problems and are looking to increase noncash trade. [REDACTED]

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Beijing stands to derive several benefits from technical cooperation with the USSR as well. Soviet technology is, for the most part, ahead of China's but not so

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advanced as to cause the same absorption problems that have occurred with some advanced Western technologies introduced to China. Moreover, China will be getting assistance in heavy industry, a sector that Chinese officials claim Western investors generally avoid. We believe another factor that makes these projects acceptable to Beijing is the relatively short duration of the prospective Soviet presence at the project sites.

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In our view, Moscow gains primarily the appearance of warming relations with Beijing. But the Soviets will also be able to export Soviet capital equipment and technical assistance--commodities for which there is little demand in the West--in exchange for Chinese goods. Moscow may also hope to gain access to some of the Western technology or equipment that has been integrated into China's factories, although we expect the Chinese to strictly limit Soviet access to sophisticated Western hardware.

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#### **Minimal Impact on Sino-US Trade**

We do not expect expanded Sino-Soviet trade to cut substantially into US-China trade, largely because China has a clear preference for advanced Western goods. Moreover, China will continue to need US expertise and equipment for development of its industries, services, and infrastructure. The Chinese will, however, use every opportunity to use barter rather than foreign exchange, and increased purchases of Soviet raw materials or low-level technology goods--timber, nitrogen fertilizer, selected industrial chemicals, and basic machine tools, for example--may dampen some US sales. On the export side, Soviet markets provide China an outlet for products that the United States and other Western governments restrict, such as textiles and footwear.

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